

**Securities Industry Association**

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March 11, 1997

Mary L. Schapiro
President
NASD Regulation, Inc.
1735 K Street, N.W.
Washington, D.C. 20006-1506

Re: Arbitration of Employment Claims

Dear Ms. Schapiro:

We write to offer our comments on the February 3, 1997 letter from three members of Congress to The Honorable Arthur Levitt, Chairman of the Securities and Exchange Commission ("February 3 letter"), which criticizes the process for arbitration of employment disputes that has been established by self-regulatory organizations ("SROs"). The letter ignores Congress' express endorsement of such arbitration and is inconsistent with the national trend to resolve disputes through alternative dispute resolution, as recognized by the U.S. Supreme Court's rulings over the last fifteen years. Indeed, the Supreme Court has referred to criticisms of arbitration such as those set forth in the February 3 letter as "'far out of step with our current strong endorsement of the federal statutes favoring this method of resolving disputes.'"¹ In our view, the criticisms voiced in the February 3 letter are based on misconceptions of how the arbitration process works.

Arbitration is in fact the least expensive, most efficient and fairest means of resolving employment disputes. The January 1996 Report of the Arbitration Policy Task Force to the Board of Governors of the NASD ("Ruder Report") considered the issues concerning arbitration and correctly concluded that employment-related disputes should remain eligible for NASD arbitration.² Nothing has happened in the last year that should change that conclusion.

I. CONGRESS HAS EXPRESSLY ENDORSED ARBITRATION OF EMPLOYMENT DISCRIMINATION CLAIMS.

The February 3 letter is grounded on the erroneous premise that arbitration of employment discrimination disputes runs contrary to Congressional intent and deprives individuals of substantive statutory rights.

To the contrary, Congress has explicitly endorsed the resolution of statutory claims by arbitration, including employment discrimination claims. Congress enacted the Federal

Arbitration Act ("FAA")³ specifically in order to encourage the enforcement of arbitration agreements. As the U.S. Supreme Court has noted, the FAA constitutes a "congressional declaration of a liberal federal policy favoring arbitration agreements." ⁴

As to the notion that an employee who agrees to arbitrate discrimination claims gives up rights, the Supreme Court has expressly held, in upholding the same Form U-4 arbitration agreement that is the subject of the February 3 letter, that "[b]y agreeing to arbitrate a statutory claim, a party does not forgo the substantive rights afforded by the statute; it only submits to their resolution in an arbitral, rather than a judicial forum."⁵

The February 3 letter, although it purports to rely on employment discrimination statutes, makes no mention of the Civil Rights Act of 1991,⁶ which amended those statutes to add a provision endorsing arbitration as a fair and effective means of resolving employment discrimination disputes. Section 118 of the Act provides as follows:

"Where appropriate and to the extent authorized by law, the use of alternative means of dispute resolution, including settlement negotiations, conciliation, facilitation, mediation, fact-finding, mini trials and arbitration, is encouraged to resolve disputes arising under the Acts or provisions of Federal law amended by this title."⁷

Since the passage of the 1991 Civil Rights Act, courts have noted that Section 118 constitutes a clear Congressional endorsement of arbitration, including arbitration of employment discrimination claims pursuant to the Form U-4 arbitration agreement entered into by registered representatives of the NASD.⁸

More fundamentally, the FAA has repeatedly been held to confirm Congress' explicit endorsement of arbitration of all manner of disputes. The Supreme Court noted in 1995 that Congress' purpose in enacting the FAA was "to overcome courts' refusal to enforce agreements to arbitrate."⁹ As a federal appellate court recently held,¹⁰ "[t]he FAA not only reversed the judicial hostility to the enforcement of arbitration contracts, but also created a rule of contract construction favoring arbitration."¹¹

II. THE COURTS HAVE APPROVED OF ARBITRATION AS AN EFFECTIVE AND FAIR MEANS OF RESOLVING EMPLOYMENT CLAIMS.

The United States Supreme Court too has recognized the salutary aspects of arbitration of employment claims. In its landmark decision in **Gilmer**, ¹² the Court upheld the arbitration of age discrimination claims pursuant to the Form U-4 agreement. After reiterating Congress' strong endorsement of arbitration agreements, and rejecting criticisms of the arbitration process, the Court stated that "[s]uch generalized attacks on arbitration 'res[t] on suspicion of arbitration as a method of weakening the protections afforded in the substantive law to would-be complainants,' and as such, they are 'far out of step with our current strong endorsement of the federal statutes favoring this method of resolving disputes.'" ¹³ The Court considered the arbitration procedures used by the self-regulatory organizations in detail and rejected criticisms of them.¹⁴

Since the Supreme Court's decision in **Gilmer**, courts throughout the United States have upheld agreements to arbitrate disputes arising out of all manner of discrimination statutes, rejecting precisely the sorts of criticisms contained in the February 3 letter.¹⁵

III. CRITICISMS OF THE ARBITRATION PROCESS ARE MISPLACED.

The criticisms detailed in the February 3 letter are based principally on erroneous extrapolations from a brief report released by the General Accounting Office in 1994 ("1994 GAO Report").¹⁶

A. Arbitrator Training

The assertion in the February 3 letter that "arbitration panels are likely to be made up of individuals . . . who have no expertise in this area of law" is simply wrong. In fact, quite the contrary is true. The SROs actively sponsor training programs on employment discrimination law for which they actively recruit participants. As the Ruder Report noted, in 1994 alone, the NASD conducted training sessions on employment arbitration that were attended by approximately 700 arbitrators.¹⁷ As one example of the training that is given, both the NASD and NYSE have participated in a training program sponsored by the Association of the Bar of the City of New York, a neutral body made up of representatives of employers and employees. Each training session is conducted by lawyers representing both employers and employees. The result, in the words of an independent publication that reviewed one of the sessions of that program, was "commendably objective."¹⁸ The NASD prepared a professionally edited videotape of the Association of the Bar training program, which it uses in training sessions throughout the country. Other training efforts continue as well.

The criticism of the supposed lack of training by arbitrators is also logically unsound. Juries have no training in discrimination law either, and there is no reason to suppose that a judge's instructions to a jury concerning the law leave the jury any more informed than arbitrators; particularly when arbitrators -- unlike juries -- frequently have received specific training in this area. Nor are discrimination claims any more complicated than other legal claims that have been successfully arbitrated for years, including securities, antitrust, labor and RICO claims.

B. Arbitrator Selection

The February 3 letter prominently emphasizes statements in the 1994 GAO Report concerning the demographic makeup of the overall pool of SRO arbitrators.¹⁹ The GAO admitted in its report, however, that it did not know the actual demographic makeup of the pool of arbitrators, but was speculating about the matter, using incomplete data.²⁰

The fact is that, as the Ruder Report notes, the SROs take active steps to recruit women and minority arbitrators.²¹ Moreover, the 1994 GAO Report's speculation about the entire pool of arbitrators says nothing about the arbitrators who are chosen by the SROs to participate in employment discrimination cases. In our experience, the SROs act conscientiously to ensure that the panels hearing such claims are appropriate in all respects.

The February 3 letter recites the GAO's speculation concerning the demographics of the entire pool of arbitrators without any attempt to explain its supposed significance. The SEC, in commenting on a draft of the GAO Report, noted that "GAO focussed its attention on some aspects of the general operation of the forums, particularly issues related to the composition of the arbitrator pool, and **again did not find problems that affected any particular cases.**"²² In that same comment, the SEC further noted that there was not "any indication of bias in the administration of the [discrimination] claims" that the GAO reviewed.

C. The Arbitration Process is Fair.

The February 3 letter's conclusory "question about the impartiality of arbitration" is without foundation. The SRO arbitration procedures provide an eminently fair forum to employees.

The process gives employees extensive opportunity to collect evidence. Employees are given broad leeway to demand and receive all manner of pertinent documents and information from employers prior to the hearing, often without the sort of limitations to which they would be subject in court cases. At the hearing itself, the strict rules of evidence used by courts do not apply. As the U.S. Supreme Court noted in **Gilmer**,²³ this is a distinct advantage for employees, as it allows them to put before the arbitrators all manner of "evidence" that would never see the light of day in court.

Perhaps most important for employees, arbitrators only very rarely dismiss cases before the hearing. In court, employers can much more readily obtain pre-trial dismissal of meritless claims. In arbitration, employees get their "day in court" on their claims and, indeed, obtain awards in cases that likely never would have survived in court.

It also simply is not true that arbitration hearings are dominated by industry employees, as some critics have asserted. NASD and NYSE rules require that two of the three arbitrators assigned to hear each employment case must come from outside the securities industry. The one arbitrator who is from the industry cannot be associated with the firm involved in the case, and, like all arbitrators, must abide by rules requiring him or her to disclose "any circumstances which might preclude such arbitrator from rendering an objective and impartial determination."²⁴ The fact that one impartial arbitrator is knowledgeable about how the securities industry works therefore serves to benefit all parties. Moreover, each party has the unlimited right to challenge the selection of any arbitrator for cause, as well as the right to make one "peremptory" challenge, *i.e.*, to remove an arbitrator without having to offer a reason.

Finally, underlying the February 3 letter's assertion of partiality is the unfounded implication that employees cannot win. The same 1994 GAO Report on which the February 3 letter relies, however, reports that of the 18 discrimination claims in arbitration studied by the GAO, the employee prevailed in 10, or 55%.²⁵ Although comparable statistics for court cases are hard to come by, it is instructive to note that in prior years only approximately 4.5% of employment discrimination claims filed with the federal Equal Employment Opportunity Commission resulted in a finding by the EEOC of "probable cause" to believe they have merit. A 55% success rate for employees in arbitration is hardly indicative of a proceeding biased against them.

Those who support a ban on compulsory arbitration of employment discrimination claims do not at the same time defend the system for resolving discrimination claims in court. The salient feature of court proceedings in employment discrimination cases is not their fairness but their enormous cost.

IV. THE ARBITRATION PROCESS IS LAWFUL AND APPROPRIATE.

The February 3 letter's assertion, without citation to any authority, that SROs exceed their authority by entering into agreements to arbitrate employment discrimination claims as opposed to other employment claims is plainly wrong. There is no basis for distinguishing between arbitration of discrimination claims and the other employment claims that are indisputably

subject to SRO arbitration, such as contract, defamation, RICO and other claims. The Supreme Court made the same point in **Gilmer**.²⁶ Certainly, Congress has made no such distinction.

Employees who bring claims against employers routinely combine discrimination claims with other employment claims. A ban on arbitration of statutory discrimination claims would lead to duplicative, bifurcated arbitration and litigation, which would impose a great burden on both the judicial and the arbitral systems, as well as on the parties themselves. This is the polar opposite of what Congress intended.

Finally, in a decision dated February 21, 1997, the United States District Court for the Northern District of Illinois dismissed claims brought against the NASD and the New York Stock Exchange, in which the plaintiff had argued that arbitration of discrimination claims deprived her of Constitutional due process and statutory rights.²⁷ The court in that decision rejected arguments akin to those in the February 3, 1997 letter.

Simply put, there is no basis for the assertion that the arbitration system run by the SROs is anything but proper, effective and useful.

V. ARBITRATION IS FAIR AND IMPORTANT.

There are those who oppose arbitration on mistaken but principled grounds. But there can be no question that among those who criticize arbitration are advocates who do so with the intent of taking maximum advantage of the failings of the civil trial system.

The civil trial process for employment claims is long and burdensome. Even those employers who prevail after a jury trial sustain immense costs and disruption in doing so. Faced with the prospect of huge costs even if they win, many employers choose to settle meritless claims rather than fight them in court. As one commentator has put it, the current court system for adjudicating discrimination claims allows for "legalized blackmail."²⁸

Arbitration, by contrast, offers all parties a faster and more efficient means of resolving claims. We strongly urge that the NASDR follow the recommendations of the Ruder Report, and that it not abandon a system that has served, and continues to serve, so many so well.

Sincerely,

Securities Industry Association
Stuart J. Kaswell
Senior Vice President and General Counsel

Bear, Stearns & Co. Inc.
Dean Witter Reynolds, Inc.
Goldman, Sachs & Co.
Lehman Brothers Inc.
Merrill Lynch, Pierce, Fenner & Smith Inc.
Morgan Stanley & Co. Inc.
Oppenheimer & Co., Inc.
Paine Webber Incorporated
Smith Barney Inc.

cc:Honorable Arthur Levitt, Chairman, Securities and Exchange CommissionLinda Fienberg, NASDR

Footnotes

1 *Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. 20, 30 (quoting *Rodriguez de Quijas v. Shearson/American Express, Inc.*, 400 U.S. 477, 481 (1989)).

2 Ruder Report at 119.

3 9 U.S.C. § 1, *et seq.*

4 *Moses H. Cone Memorial Hospital v. Mercury Construction Corp.*, 460 U.S. 1, 24 (1983).

5 *Gilmer*, 500 U.S. at 26 (quoting *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 628 (1985)). **See also** *Kuehner v. Dickinson & Co.*, 84 F.3d 316, 320 (9th Cir. 1996)(holding that NASD arbitration "does not affect [claimant]'s substantive rights . . .").

6 Pub. L. No. 102-166, 105 Stat. 1045.

7 *Id.* § 118.

8 *See, e.g., Austin v. Owens-Brockway Glass Container, Inc.*, 78 F.3d 875, 881 (4th Cir. 1996) (holding that the language of the 1991 Act "could not be any more clear in showing Congressional favor towards arbitration" and that agreements to arbitrate both Title VII and Americans with Disabilities Act statutory claims were enforceable); *Maye v. Smith Barney Inc.*, 897 F. Supp. 100, 107 (S.D.N.Y. 1995), request for leave to appeal denied, 903 F. Supp. 570 (S.D.N.Y. 1995) (referring to "seemingly unambiguous Congressional endorsement of arbitration in § 118").

9 *Allied-Bruce Terminix Cos. v. Dobson*, 513 U.S. 265, 115 S.Ct. 834, 838 (1995).

10 *Kuehner*, 84 F.3d at 319.

11 If any further proof were needed that the criticisms of arbitration set forth in the February 3 letter do not accord with Congressional intent, it can be found in the fact that bills have been introduced in each of the last two Congresses that would have barred mandatory arbitration of employment discrimination claims pursuant to private agreements, and those bills encountered no material support. No action was taken on the bills. **See, e.g.,** H.R. 4981, 103d Cong., 2d Sess. (1994); S. 2405, 103d Cong., 2d Sess. (1994); S. 366, 104th Cong., 1st Sess. (1995).

12 500 U.S. 20.

13 *Id.* at 30 (quoting *Rodriguez de Quijas*, 490 U.S. at 481).

14 *Id.* at 30-32.

15 *See, e.g., Alford v. Dean Witter Reynolds, Inc.*, 939 F.2d 229 (5th Cir. 1991) (compelling arbitration of Title VII claim); *Bender v. A.G. Edwards & Sons, Inc.*, 971 F.2d 698 (11th Cir. 1992); *Mago v. Shearson Lehman Hutton, Inc.*, 956 F.2d 932 (9th Cir. 1992); **see also** *Cole*

v. **Burns International Security Services**, 1997 U.S. App. LEXIS 2223 (D.C. Cir. 1997); **Austin v. Owens-Brockway Glass Container Inc.**, 78 F.3d 875 (4th Cir. 1996) (claims under Title VII and Americans with Disabilities Act); **Scott v. Merrill Lynch, Pierce, Fenner & Smith, Inc.**, No. 89 Civ. 3749, 1992 U.S. Dist. LEXIS 13749 (S.D.N.Y. Sept. 10, 1992)(claim under 42 U.S.C. § 1981).

16Employment Discrimination: How Registered Representatives Fare in Discrimination Disputes, United States General Accounting Office Report to the Chairman, Subcommittee on Telecommunications and Finance, Committee on Energy and Commerce, House of Representatives (March 1994).

17 Ruder Report at 117.

18 Arbitration Training: Employment Law Seminar, Sec. Arb. Commentator, June 1993, at 8.

19 Supra note 16 at 8-9, 23.

20 Id.

21See Ruder Report at 117.

22 Letter from Robert L.D. Colby, Deputy Director, Securities and Exchange Commission, to Linda G. Morra, Director, Education and Employment Issues, United States General Accounting Office (Dec. 30, 1993) (Appendix II to 1994 GAO Report)(emphasis added).

23 500 U.S. at 31.

24See, e.g., NYSE Arbitration Rules, Rule 610(a); NASD Code of Arbitration Procedure, § 10312(a).

25Supra note 16 at 8.

26 500 U.S. at 27-28.

27Cremin v. Merrill Lynch Pierce Fenner & Smith, Inc., No. 96 C3773 (N.D. Ill. February 21, 1997).

28 Jay Finegan, **Law and Disorder**, Inc., April 1994, at 64. **See also** Max Boot, **For Plaintiffs' Lawyers, There's No Place Like Home Depot**, Wall Street Journal, February 12, 1997, at A17.